Dental Economics

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Managing your expectations

If retirement is not mandatory, the first question to answer before you sell your practice is, "How do I know if I have enough money to retire?" This column outlines the information you must gather in order to determine your choices on transitioning your practice.

Let's examine the protocol for planning retirement.

Determine your expenses for one year

❶ *Calculate on a monthly basis what you spend* on food, housing, gas, utilities, medical expenses, medical insurance, car insurance, entertainment, clothing, gifts, golf, travel, etc. (use last year's checkbook and credit card bills as aids).

❷ *Include income tax payments and replacement of major items such as an auto or a new roof.* (For example, if you pay $35,000 for a car and keep it for seven years, add $5,000 per year for auto; if a roof costs $6,000 and is replaced every 15 years, add $400 a year for a roof.)

❸ *Be realistic about how you spend money.* Most people travel more in retirement.

❹ *Total all of the above expenses to determine your yearly financial needs.*

Determine your retirement income for one year

A. After retirement, do you plan to live strictly off of the income from your investments (leaving the principle for emergencies or for your children) or

B. Do you plan to live on a combination of the income and principle of your investments (hoping you take your last breath as you spend your last dime).

If the answer is "A — Live on the income and leave the principle," add the following:

1. Yearly income from your present taxable investments.
2. Income from IRAs and Social Security.
3. Income from money invested from the practice sale.

For example, let's say you plan to sell your practice for $300,000. You will pay a minimum of 15 percent in taxes, leaving $255,000 to invest. Invested at 5 percent interest, your yearly income from this investment will be $12,750.

4. The total of 1 + 2 + 3 = yearly income.

If the answer is "B — Live on income and principle," your CPA or CFP will calculate your expected yearly income based on your life expectancy. He or she will calculate your future income from Social Security, current taxable investments, IRAs, and the investment of the proceeds from the practice sale (after taxes). Use your CPA's figure as your yearly income.

Subtract your total expenses from your total income to determine your practice transition options

A. If the yearly income is larger than your planned expenditures, then congratulations! You can sell your practice now and retire or work part time for the buyer if your practice income allows this option.

B. If your expenditures are larger than your income, you again have two possibilities.

1. If your practice is large enough to cover your needs and still entice a buyer, you may sell your practice and work for the buyer. For example, after subtracting the note on the purchase price and the overhead from a practice grossing $350,000, a buyer has $131,000 for the buyer's and seller's salaries. If the seller requires $40,000 to supplement his post-sale income, $91,000 would be left for the buyer. A buyer would probably take this risk.

However, if the seller required $80,000 to supplement his post-sale income, only $51,000 would be left for the buyer. Few buyers would take the risk of purchasing a practice for $51,000 a year. The less your practice has to pay you as an associate after the sale, the more attractive the practice becomes to a potential buyer. Remember, most young dentists earn $70,000 per year without taking on the risk or headache of purchasing a practice.

2. If the disparity between your needs and your retirement income is too large and your practice does not produce enough income to support you and still entice a buyer, it is too early for you to sell your practice. It is time, however, to meet with your CPA or CFP and design a strategy to reduce your living costs, increase your secure investments, and form a reasonable time frame to transition your practice in the future.

Don't sell yourself short — do your homework. When you know how much you will need to meet your financial needs, a broker can structure and time your transition to best suit you.

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